# Report on

CUSTOMS BANK GUARANTEES

**and**

**PENALTY-BASED CUSTOMS INCENTIVES**

Access to Microfinance and Improved
Implementation of Policy Reform (AMIR),
USAID Mission to Jordan

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## EXECUTIVE SUMMARY

In 1998, the AMIR Program developed an Investor Road Map to identify procedural reforms aimed at removing administrative barriers to investors. Among the reforms were a number of problems in the area of customs operations. Some of those problems have already been solved through the ongoing reform program of the Jordanian Customs Department. However, 2 customs problems remained – bank guarantees were too costly and penalty assessments were too high due to the incentive created by the "bounty" system. A special consultant study was requested to determine how these continuing barriers can be not only overcome, but removed.

Concerning bank guarantees, the study found that the Customs Department has made substantial progress toward lowering bank guarantee costs, by establishing blanket guarantees for a number of customs procedures and by establishing a policy of allowing potential liability for duties to exceed the amount of the guarantee. The study recommends that the Customs Department continue along this path and (1) expand blanket guarantees to more procedures, (2) consolidate blanket guarantees into fewer kinds of guarantees, and (3) use risk analysis procedures to safely allow liability to exceed guarantee amounts in the case of more kinds of customs procedures. Also, the report recognizes the opportunity for banks to reduce their changes for bank guarantees by (1) removal of a Central Bank ceiling on commission rates, allowing a rationalization of the rates and the lowering of collateral requirements, and (2) establishment of risk analyses by the banks that take into account the performance of parties covered by customs bank guarantees in setting commission rates and collateral requirements.

In the area of penalty-based incentives, the study found that the Customs Department has made some progress, but not as much as in the case of the bank guarantees. Customs Law No. went into effect on January 1, 1999, and it reduced penalty amounts, established the GATT Definition of Value (ending the past practice of arbitrary valuation uplifts and resultant penalties), and lowered the share of penalties allocated to customs employees finding violations from 40% to 33%. Also, the Customs Department set a monthly limit on the earnings of employees from the incentive system.

The study recognizes the complexity of quickly ending the bounty system, because it has become a substantial part of the paychecks of many Customs employees. If the system is to be abolished, a comparable wage and incentive package must be put in place in its stead. Therefore, the study recommends that the Customs Department, Ministry of Finance, and the GOJ undertake this change as a long-term goal, for accomplishment in not less than 3 years.

However, there is much that can and should be done in the short term. The study recommends that the Customs Department establish a comprehensive incentive plan to allow all employees to participate in the incentives. The incentive plan should continue to be funded from the 33% share of penalties. The Customs Department should also develop and implement a comprehensive compliance plan, to use compliance methods designed more to avoid or prevent violations. Penalties would, of course, continued to be levied, where necessary. Several changes should be made in Customs Law No. 20 to (1) eliminate clerical errors and discrepancies that are matters of legal interpretation from the list of customs offences, (2) eliminate some anomalies in the penalty system, (3) better regulate the performance of clearing agents, and (4) impose a record-keeping requirement on importers.

# IMPROVING JORDANIAN CUSTOMS PENALTY AND GUARANTEE SYSTEMS

## I. Background and Purpose of Task

Customs administrations play an important role in national, regional, and international economic development, particularly with the increase in recent years of trends toward globalization and an international market economy. To optimize the role of trade, the nations of the world, working through international organizations, have harmonized tariff systems, agreed on a common method of valuation of goods, and are working toward a common system of rules of origin.

The nations have also recognized the importance of reducing procedural barriers to international t rade. Article VIII of the General Agreement on Tariffs and Trade recognizes an obligation of its contracting parties to minimize the incidence and complexity of import and export formalities and to not allow customs charges to represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes. Recognizing the potential of customs procedures to become non-tariff trade barriers, the World Customs Organization developed the International Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Convention) to serve as a model of customs procedures that reduce customs procedural formalities, yet allow customs administrations to properly enforce national laws. The Kyoto Convention is now in the final stages of a fundamental revision which will strengthen its application to the obligations of Article VIII of the GATT.

The Access to Microfinance and Improved Implementation of Policy Reform (AMIR) of the USAID/Jordan seeks to improve Jordan's economy by improving the business environment with a view to encourage private investment, both local and foreign. To this end, AMIR developed an Investor Road Map in 1998 to guide local and foreign investors through Jordanian requirements for approving new investment, licensing, land access, site development, and operational requirements, and to suggest improvements. Among the various operational requirements, the Road Map proposed a number of changes in customs procedures, including (1) replacement of the "bounty" system, whereby a customs officer finding a law violation receives a share of the fine for the violation, and (2) modernizing the bank guarantee system to reduce the cost of the guarantees. These procedures affect the ability of investors to obtain goods, and to manufacture them for re-exportation, at a reasonable cost and with a reasonable profit expectation.

To assist the Government of Jordan (GOJ) in implementing the latter recommendations, AMIR developed a Statement of Work (SOW) for an independent consultant to:

1. Propose to the Customs Department alternatives to the existing bounty system and bank guarantee system; discuss the alternatives with the Customs Department; and convince them to adopt new systems to replace the "bounty" system and the existing bank guarantee system;

2. Develop a proposal for implementing the new systems, working with a local attorney on developing any legal solutions to replace the old systems and introduce new ones; and

3. Provide guidelines and training (if needed) to customs officers in implementing the new systems.

In making the recommendations of the Investor Road Map, the AMIR recognized many past and ongoing achievements of the Customs Department in modernizing its procedures by implementing (1) a new declaration form based on the Single Administrative Document (SAD), (2) an electronic processing system based on the ASYCUDA system developed by UNCTAD, and (3) a computerized system for drawback and temporary admission. Furthermore, the SOW recognized that the ongoing Jordanian Customs reform program has addressed all of the customs issues identified in the Investor Road Map except the bank guarantee and penalty/incentives systems.

The USAID had earlier recognized a continuing problem with the Customs penalty/incentive system, conducting a consultant study and recommendations in 1994 under its Sector Policy Reform Technical Report Project. The purposes of that study were to recommend (1) a new categorization of infractions and fines to be applied in the clearance of goods through customs, (2) new procedures for the application of fines, including the level of authorities in the administration of the application of fines, and (3) a new incentive system for customs officers. The Baseline Efficiency Study of Jordanian Customs conducted for AMIR in 1998 noted that some of the recommendations of the 1994 study had not yet been carried out. On the other hand, other recommendations of the 1994 study have been carried out, within the scopes of the SAD and ASYCUDA projects.

The bank guarantee system and the penalty/incentive system are not closely related to one another. However, they both are, or have the potential for becoming, customs procedural barriers to international trade. Therefore, they are treated separately in this report and its recommendations.

The findings and recommendations of this report are based on the interviews shown in Annex A of this report; information otherwise available to AMIR; and the information and experience of the consultant.

## II. Findings and Conclusions

### A. Bank Guarantees

Guarantees are widely used by customs administrations to assure the payment of duties and taxes and compliance with other customs obligations. They are addressed in the Kyoto Convention under the definition of “Security”” - that which will assure to the satisfaction of the Customs that an obligation to the Customs has been fulfilled. This general definition is used because there is a wide variety of types of guarantees internationally, including cash deposits, bonds, and other kinds of promises to pay or comply which are sanctioned and enforced, to varying degrees, by national legislation.

Jordanian law, in Law 20, authorizes three types of customs guarantees: (1) a cash deposit, whether currency, certified check, or similar kind of monetary instrument; (2) a guaranteed undertaking, which is a promise to pay, as more of a moral, rather than a legal obligation; and (3) a bank guarantee.

A bank guarantee is a three-party contract wherein a bank (Party 1) agrees to become jointly and severally liable to the Customs Department (Party 2) for compliance with the obligations of the guaranteed party (Party 3), whether an importer, clearing agent, carrier, or other party to a customs obligation. If the guaranteed party does not comply with its payment or other obligations, the bank agrees to pay the Customs Department the obligated amount, up to the monetary limit of the guarantee. Law 20 requires or allows customs bank guarantees in many kinds of circumstances.

The wording of bank guarantees is determined by the Customs Department and the guarantees are implemented through standard forms and procedures. The guarantee sets forth the maximum amount for which the bank is liable to Customs, since the exact amount of Customs liability depends on the circumstances of a default by the guaranteed party. Guarantees may be (1) specific, that is related to one transaction of a given type, or (2) general, that is related to multiple transactions of a given type. General guarantees may be considered the same as the “blanket” guarantee mentioned in the Investor Road Map.

#### 1. Bank guarantee procedures

##### a. Guarantee issuance

To obtain a bank guarantee, when required by the Customs Department, an importer makes application to a bank, almost always a bank at which it does business for other purposes, such as commodity or working capital loans, letters of credit, mortgages, and similar purposes. Banks rarely issue a guarantee if the importer is not already one of the bank’s customers. For the guarantee service, the

bank charges a commission of up 2% of the amount of the guarantee for the period of the guarantee[1], the maximum commission allowed by the Central Bank for most customs guarantees. A higher commission of up to 4% is charged for guarantees for non-certified checks.[2] Depending on the quality and quantity of the customer's assets in the bank, the bank also imposes a collateral requirement, usually a cash deposit ranging from 0% to 100% of the guaranteed amount.[3] In effect, the bank insures itself against poor risks through the collateral requirement and rewards good customers by lowering the commission rate.

For temporary importations of goods and components for manufacturing and re-export[4], it is typical of a bank to group customers into 2 types: (1) foreign and (2) domestic. Domestic customers are further grouped into (1) customers with ample assets and (2) those with few assets. For foreign customers, the bank demands a counter-guarantee issued by a correspondent bank, normally in the country of the foreign customer. The bank charges a 1% commission, and the counter-guarantee is considered to satisfy any collateral requirement. For domestic customers, the rate will vary with the quality and quantity of the assets, and the collateral requirement for temporary importations by little-known domestic customers with few assets will reach as high as 100%.

When the applicant receives the written guarantee of the bank on the Customs form, it transmits it to the Customs Department for acceptance. Upon acceptance, the guarantee goes into legal effect.

b. Guarantee administration by Customs

Specific guarantees are normally presented by the obligated party to the Customs Center where the obligation is required. The guarantee is reviewed by a Customs officer at a guarantee desk before acceptance. The declaration for the goods will not be approved for processing unless the required guarantee is accepted. The amount of the guarantee must usually cover the liability of the guaranteed party for any given transaction or declaration. After acceptance by Customs, the guarantee is forwarded to Customs Department Headquarters. Most Customs guarantees are accepted only at the 5 major Customs Centers of Amman Custom House, Amman International Airport, Aqaba, Zarka Free Zone, and Sahab Industrial Estate.

General guarantees are accepted only at Customs Headquarters. In the case of general guarantees for temporary admission, they are presented to the Headquarters Temporary Admissions Office. After review and acceptance, the Office inputs the guarantee information into its automated system which is transmitted to the 5 principal Customs Centers.

When an obligation is completed, in the procedure required by Customs, the guaranteed party and the bank are acquitted of responsibility under the guarantee. In the case of temporary admissions, this usually occurs when the goods are re-exported, as confirmed by an import declaration upon entry into a neighboring country.[5] However, the guarantee may be acquitted upon declaration for home use, with the approval of the Department, and the consequent payment of duties, and any other disposition authorized

[1] The actual rate charged may be lower; a rate as low as .125% was charged by one bank.

[2] Banks also issue guarantees for many kinds of non-customs guarantees, such as letters of credit, performance guarantees, and penal bonds.

[3] The Investors Road Map cites, under its Procedures for Temporary Entry of Raw Materials, the "submittal of bank guarantee for 10% of the value of the materials". It is assumed that this is a reference to the bank's cash deposit requirement. It is not known whether this was regarded as a typical amount, or the amount for one given case.

[4] Temporary importations are allowed, under Customs Law No. 20, for re-exportation in the same form without payment of duty; re-exportation, after payment of duty, in the same form or after manufacturing, for duty refund or drawback; and for manufacturing and re-export without payment of duty. For the purposes of this report, the term "temporary admission" means temporary importation free of duty for manufacturing and re-export.

[5] An import declaration from the importing country is not required for re-exportations from the Aqaba seaport or airport or the Amman airport. Import declarations are required for re-exportations via land borders because customs entry points are usually located in isolated locations, not close to Customs entry points on either side of the border. Consequently, reintroduction into Jordan without customs formalities is a distinct possibility, if not an actual threat. However, the Customs Department is said to have under consideration relief from the import declaration requirement for some land border exportations.

by law for temporary admissions. Such an acquittal method applies also to other kinds of general guarantees, such as transit bonds.

The obligation under a general guarantee continues for all other goods for which responsibility has not yet been acquitted. The balance of the amount of the guarantee not yet acquitted is carried in the automated temporary importation system, which is monitored by the Customs Centers. In concept, if a new temporary importation would increase the balance beyond the amount of the general guarantee, the declaration would not be accepted until the amount of the guarantee is increased.

However, the Temporary Admissions Office has initiated a new method which allows an increase in duty liability up to double the amount of the guarantee. Thus, if an importer has a guarantee for up to 100,000 JD, it may incur an actual liability of up to 200,000 JD. A new declaration would not be rejected unless the additional duty liability would run the balance beyond the 200,000 JD limit. Such a privilege is allowed under a scoring system which, generally, rates the risk represented by the importer. However, 40% of the scoring system rates the importer for non-risk factors, such as the number of employees, percentage of products re-exported, and percentage of use of local materials. On the other hand, the system does not take into account some risk factors relating to the goods themselves, such as a high rate of duty, high value to weight ratio, or proneness or attractiveness to theft. A directive or instruction has not yet been issued for the new practice of allowing a liability increase beyond the amount of the guarantee. It is understood that it has been publicized in the daily newspapers; however, it does not appear to be widely known in the trade.

A new directive, Circular No. 92 of 1999, authorizes liability exceeding the amount of general guarantees for (1) transit guarantees and (2) guarantees for imported supplies for governmental projects. The amount of the increased liability depends on the amount of the guarantee, not on the risks encountered in exceeding the guaranteed amount. For example, liability under a transit general guarantee of 600,000 JD or more may be increased to up to 5 times the amount of the guarantee. On the other hand, a transit guarantee is valid only at one center. An importer (or, more usually, a clearing agent) filing a transit declaration at more than one location, must have a general guarantee for each such location. By way of contrast, a general guarantee for temporary admission covers importations and re-exportations at all Customs Centers.

When a general guarantee is scheduled for expiration, the Customs Department will notify the guaranteed party to renew the guarantee. Customs does not notify the guaranteeing bank, nor does the guaranteeing bank notify the guaranteed party. If a guarantee is not renewed, the Customs Department will issue a demand for payment of any duties and charges for which the guaranteed party is liable. If the guaranteed party does not apply to the bank for renewal, and pay the required bank commission, before the expiration date, the bank will charge a late fee of up to 2% of the amount of the guarantee. The 2% limit is set by the Central Bank. If the party does not renew within a certain agreed period, say, 3 months, the bank will not issue a renewal. Instead, the party must apply for a new guarantee.

The guarantee is considered finally terminated when Customs surrenders the written guarantee to the guaranteed party and the guaranteed party returns it to the bank.

c. Defaults in Guarantees

If a guaranteed party fails to honor its obligations under the guarantee, the Customs Department will issue a demand for payment of the duties and charges involved in the default. If the guaranteed party does not pay within the specified time, usually 30 days, the Customs Department will issue a demand for payment by the guaranteeing bank. Under the standardized guarantee agreement format, if the bank fails to pay, the bank authorizes the Central Bank to pay the amount in default.

The rate of default for most Customs guarantees is estimated to be less than 1%. The rate of defaults under general guarantees for temporary admission is somewhat higher, from 5 to 10%. The higher rate of default for temporary admission guarantees is said to be due to a few failures of small temporary admission investments.

When Customs demands payment by the bank for a defaulted amount, the bank promptly pays Customs. There appear to be few cases in recent memory where a bank failed to pay Customs. The bank recovers the amount of the default payment from the guaranteed party by taking possession of any collateral cash deposits and transferring the remaining amount from other accounts of the guaranteed party in the bank. If a defaulting party applies for another guarantee by the bank, the bank will consider the quality and quantity of the customer's assets and may issue a new guarantee, perhaps with a higher collateral requirement. Neither the customer's default rate with Customs, nor the rate of Customs demands made upon the bank, appear to have much impact on future bank decisions on applications for guarantees by the same party.

Although Customs risks have been well covered by bank guarantees, Customs faces difficulties in recovering amounts not covered, or in excess of the amounts covered, by a bank guarantee. Article 244 of Law 20 gives the Customs Department a priority claim over the property of the person liable for payment of Customs debts, even in cases of bankruptcy. However, court procedures for enforcing such claims are time-consuming, taking as long as 4 years to settle.

2. Customs progress

A problem with bank guarantees cited in the Investors Road Map was that they were a financial burden to investors, as they were expensive and tied up large amounts of capital. Importers were required to have a guarantee for each individual import instance, and some companies were required to take out several hundred separate guarantees in a year. The Road Map recommended that a blanket guarantee to guarantee all customs duties and formalities be considered, since it would spread the risks to Customs over many importations. It also recommended the elimination of the practice of taking a portion of the importer's goods in payment of customs duties and fees.

The latter practice was terminated by Customs Law No. 20 when it went into effect on January 1, 1999. The new valuation methods of the new law ended valuation uplifts, which were the source of the practice of taking the importer's goods.

Customs has begun approving general guarantees of various types, for temporary admission, clearing agents, transit, moving goods between Customs Centers and warehouses, governmental projects, and other purposes. These general guarantees have saved money for the affected parties by not requiring a new bank commission and collateral requirement for each separate transaction.

Customs has also saved investors money by allowing them to incur liability for duties and taxes above the amount of the guarantee. That is, they need not seek a bank guarantee and pay their commissions for the entire amount of their liability.

3. Conclusions

The Customs Department has made a good start toward reducing the cost of guarantees. It could do more by continuing on the path of general guarantees, risk analysis, and allowing the acceptance of liabilities beyond the guaranteed amount. The large number of kinds of guarantees could be consolidated into fewer general guarantees. Risk analysis could be expanded and refined. Acceptance of liabilities beyond the guaranteed amount could be extended beyond double the amount of duties for low-risk temporary admission importers, and the principle could be adopted for more kinds of guarantees.

The banks could also help to reduce the cost of guarantees. Caps on commissions could be raised or eliminated by the Central Bank to allow more competition and creativity in rate structures and the easing of collateral requirements. The banks could also recognize the selective risks posed by parties which have defaulted under customs guarantees, particularly those whose failure to pay requires Customs to make payment demands on the banks.

**B. Penalties and Incentives**

Under the Jordanian penalty system, a portion of the penalty paid by an offender (now 33% under Law No. 20) is deposited into an account which is distributed to the finder or finders of the violation, supervisors, fellow participants in the violation-finding effort, and also to various non-participants, according to a formula set by the Minister of Finance under Regulation No. 24 of 1999 and further defined by internal instructions of the Director of the Customs Department

The issuance of monetary penalties for violations is a well-established, widespread, and effective method of gaining compliance with Customs laws. The World Customs Organization sought to gain some international uniformity in the treatment of customs offences in Annex H.2 of the original Kyoto Convention of 1973. Unfortunately, Annex H.2 never entered into force because the required number of contracting parties (5) failed to ratify it, perhaps indicating a lack of international consensus as to what constitutes customs offences and how to deal with them. The revised draft Kyoto Convention covers customs offences in Specific Annex H, and in portions of its General Annex dealing with errors in goods declarations.

The treatment of incentives for Customs employees is not the subject of any international convention. Generally, penalty-based incentive systems do not appear to be widespread among national customs laws. Within the GOJ, Article 42 of the General Sales Tax authorizes penalty incentive payments similar to those in the Customs Law. The Income Tax law contains employee incentives in Article 50, but they are not related to income tax penalties.

The 1994 USAID study under the Sector Policy Reform Technical Support Project recommended, generally, that (1) fines should be imposed only for breaches of law and regulation done through negligence or fraud, (2) the law should impose a range of penalties ranging from mild to severe, with the Ministry of Finance setting down guidelines for fixing the amount of the individual fines, and (3) the Customs incentive system should be independent of the levying of penalties. Instead, officers should be paid an incentive calculated as a percentage of basic salary, similar to that for overtime compensation.

1. Penalty System

Customs fines and penalties are issued for a wide variety of violations, including those affecting ships and other carriers, travelers, outright smuggling, and banned substances. This report considers penalties for violations more applicable to investors, primarily those affecting the declaration and clearance of goods.

a. Penalty procedure

Customs treats any discrepancy found in a declaration, or between a declaration and its supporting document (such as an invoice), as an infraction which is subject to a penalty. When a Customs officer finds such a discrepancy, a report must be made and discussed with the head of his clearance unit to specify the particulars of the infraction. The report is sent to an Assistant Manager or the Manager of the Customs Center who makes a determination as to whether a penalty should be issued and the amount of the penalty. (Under ASYCUDA procedures, the final decision at the Customs Center is made by the Head of the Query Desk.) At that point, the importer (or, more likely, the clearing agent) is notified of the report, and is asked to read and sign it. If the clearing agent signs it, the agent becomes responsible for payment of the fine. If the clearing agent refuses to sign or disputes the amount or the fact of the violation, the report is sent to Customs Headquarters for a decision.

If a dispute revolves around the interpretation of the law concerning tariff classification, valuation, origin, or similar matter, the issue is referred to appropriate Headquarters Tariff, Valuation, or other office for resolution. After resolution of the legal interpretation, the report is referred to the Penalty Office to determine whether any penalty should be issued and the amount of the penalty. That is, the resolution of the correct value or tariff rate is treated as a separate matter from the imposition of the penalty. Disputes which do not involve a legal interpretation are referred directly to the Penalty Office. If the importer or clearing agent does not agree with the Customs Headquarters decision, it may appeal the matter further to the court.

b. Penalty decisions

Customs policy, both at the Customs Center and the Headquarters, is to issue a penalty for clerical or inadvertent errors, but to issue the minimum penalty of 25 JD allowed under Article 200(a) of Law No. 20. Headquarters usually does not issue a penalty for a dispute over interpretation of the law, unless it believes there was a clerical error, negligence, or intent involved in the case.

The clerical error and legal interpretation problems are exacerbated by the poor performance of some clearing agents. Such agents seek to attracting clients by rushing documentation to gain a quicker release time, offering to declare goods at absurdly low duty rates, and offering financial incentives to Customs officers to accept the low rates. Furthermore, the number of clearing agents has proliferated; there are 70 agents at Amman International Airport alone. This creates a burden on the Customs Department in training in new procedures, such as the SAD and ASYCUDA, so as to avoid unnecessary errors. Customs officers show some reluctance in liberalizing penalty administration that would reward agents for poor performance. On the other hand, the Customs Department limits agents' fees to their clients, which may tempt some of them to seek revenue through shady or outright illegal means.

Intent is an important factor in customs penalties because violations done with intent, under Article 205 of
Law No. 20, are subject to penalties as smuggling offences under Article 206 of the Law. If no intent is shown, they are treated as customs offences under the lighter penalties of Articles 198 through 200 of the Law. However, intent is not defined in the law.

There is somewhat of an anomaly related to penalties relating to customs valuation, weight, or measure. Under Article 198(a)(1) of the Law, a penalty is imposed for declarations in which the actual value or weight exceeds the declared value or weight by less than 10%. The amount of the penalty is one-half of the amount of duties and taxes applicable to the excess value or weight. However, if the actual value or weight exceeds the declared value or weight by more than 10%, it is automatically treated as a smuggling offence under Article 204(K) or (L) of the Law, subject to a penalty, usually, of 2 to 4 times the value of the merchandise covered by the declaration. This is done even though the difference of 10% of more may have been due to clerical error or other reason not amounting to intent, or even though no false or fabricated documents were involved in the case. This treatment may be due to a consideration that the alternative is to treat such non-intentional violations as declarations which are inconsistent with the enclosed documents under Article 200(a), for which the penalty would be only 25-100 JD's. This penalty may be less than the penalty imposed for differences of less than 10%.

Although the failure to maintain records and documents is a customs offence under Article 199(R) of the Law, there is no corresponding law requiring importers to maintain them. (There is such a requirement of clearing agents under Article 170.) When Customs officers have asked some importers to produce papers to verify the particulars of an offence, they have simply declared that they did not have them. Without the requirement itself in the law, the officers were not able to proceed with the case.

c. Customs Progress

The Investors Road Map does not mention penalty amounts or procedures directly; rather, it is more concerned with the effect of the incentive system in creating a mindset for customs officials to resort to fines to increase their personal incomes.

The 1994 USAID report under the Sectoral Policy Reform Technical Support Project cited a number of inconsistencies in penalties, many of them based on valuation practices based on the "normal value" concept[6] under the previous Customs law, Temporary Law No. 16 of 1983. No account was taken of intent, clerical error, or matters of legal interpretation in setting the penalty amount.

[6] The normal value concept was borrowed from the Brussels Definition of Value, which has been superseded in major trading countries by the GATT Definition of Value. The BDV "normal value" was what the customs value would have been, if the goods under consideration had been sold at arms length in conditions of open competition. Some customs administrations interpreted this to mean that they could substitute their own idea of what the value would have been, and could uplift declared values based on that supposition.

Customs Law No. 20 made some significant changes in penalties:

1. It established intent to violate the law as evidence of criminal liability, subject to the penalties for smuggling.

2. The minimum penalties were reduced when an amicable settlement has been reached between the offender and Customs concerning the violation.

3. Penalties for inconsistencies in declarations were reduced from 2 to 3 times the amount of duties involved in the inconsistency to a fine of 25 to 100 JD.

4. Most important, it replaced the "normal value" concept of the BDV with the "transaction value" concept of the GATT Definition of Value, greatly reducing the number of disputes and penalties arising from valuation uplifts.

As a matter of policy and practice, the Customs Department no longer issues penalties for discrepancies based on matters of interpretation of the law. It still issues penalties for discrepancies based on clerical error, but recognizes clerical error as a concept by levying the minimum fine allowed by the law.

Since the Law No. 20 has been in effect only since January 1, 1999, it is too early for statistics to show any effect on the amount of penalties levied and collected, since many penalties are finalized only after disputes are settled. The subjective feeling among Customs and the trade is that penalty incidence and amounts have decreased somewhat.

c. Conclusions concerning penalties

The Customs Department and the GOJ have made a considerable effort to moderate the penalty system to avoid unnecessary fines and reduce penalty amounts, particularly for minor errors. More needs to be done to systematize the penalty system to avoid anomalies. It is doubtful that clerical errors should be penalized at all, since they have no deterrent effect against human imperfectability. On the other hand, penalties for discrepancies resulting from negligence could be increased, and the meaning of "intent" be clarified for smuggling penalties. Also, importers could be penalized for failing to maintain proper records.

Furthermore, it appears that undue reliance is placed on penalties as a means of gaining compliance with the law by importers, clearing agents, and others. The Customs Department does use other compliance measures, such as refusing improperly-prepared documents and suspending or canceling licenses. However, penalties are over-emphasized and other means are under-emphasized. There is no comprehensive plan for addressing compliance objectives.

Customs could do more to regulate clearing agent performance. Stricter test requirements, both for new and for existing agents, would eliminate the poorer performers from the trade. It may also reduce somewhat the proliferation of agents. However, the amount of clearing agents' fees and the number of agents would better be left to free market forces.

2. Incentive System

a. Incentive Authority and Distribution

Article 242 of Law No. 20 provides that one-third of the sum of fines and the value of confiscated item paid into the Treasury be allocated for bonuses to Customs officials and employees. The bonuses are to be distributed according to the instructions of the Finance Minister upon the recommendation of the Customs Director, but that the contributions of *those directly involved* be taken into consideration.

The Customs Department also administers the General Sales Tax Law. Article 41 of the Sales Tax Law provides that 20% of sales tax fines be paid into a fund for distribution for varied, broad-based purposes which include incentives for revealing the evasion of sales taxes and seizing contraband goods. On the

other hand, Article 50 of the Income Tax Law provides for a compensation and bonus plan which is allocated entirely from the State budget.

The Finance Minister issued a recent regulation, Regulation No. 24 of 1999, directing the distribution of the bonuses under Law No. 20 in the following manner:

50% to officers who find violations and seize articles, and to their supervisors, each according to his effort.

25% to officers who did not have the opportunity to participate in a disclosure or seizure.

10% to the savings and social services fund.

10% to a discretionary fund for incentive bonuses for combating smuggling.

5% to Customs Headquarters.

Regulation No. 24 authorizes the Director of Customs to determine the methods and procedures to be followed in distribution, taking into account the effort spent in the disclosure or seizure incident. It also authorizes the Minister, upon the recommendation of the Customs Director and for justified reasons, to award a special bonus to informants and the officer who made the disclosure or seizure. (It is assumed that such bonuses are taken from the discretionary fund for combating smuggling.)

b. Distribution to individuals

The distribution scheme of Regulation No. 24 is further refined by internal unpublished instructions of the Director of Customs. The internal instructions were described orally, and no written description was provided. These instructions place a ceiling on the various participants and non-participants:

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|---|---|
| Finders of violations | 400 JD per case and 400 JD per month |
| Auditors | 300 JD per month |
| Customs Center Managers | 125% of base salary per month |
| Assistant Managers | 100% of base salary per month |
| Non-participants | 75% of base salary per month |
| Others | 75% of base salary per month. |

The division of penalty amounts among finders, supervisors, and others included in the 50% category of Regulation No. 24 is determined on a case-by-case basis. The amount of each penalty is completed paid out, through the Regulation No. 24 distribution scheme and within the above ceilings, leaving no carryover from month to month. It is understood that officers rarely reach the above ceiling amounts.

It is understood that bonuses could be paid for other achievements or acts of merit by customs employees (although it is not clear that they actually are). Such bonuses would be paid from the 25% share for non-participants.

Customs officers receive other salary supplements, beyond base salary, for overtime,[7] family allowance,[8] personal allowance, university degrees, and transportation (for certain management officials). Statistics on the amount paid out for incentives under Regulation No. 24 was unavailable, but it is understood to amount to about 40% of the total amount of base salary payments. In the case of individuals, as noted above, it can exceed the base salary. It is evident that the incentive amounts are significant, whether or not the individuals reach their monthly ceiling.

[7] The overtime allowance averages 80% of base salary. It is paid in recognition of the longer working day of Customs officers. The workday at Customs Headquarters and interior offices begins approximately one hour before and ends one hour after the official working day of other GOJ employees. At border, airport, and seaport offices, officers work 24-hour shifts, and are on call for emergency or peak-load requirements.

[8] Supplements for family allowance, personal allowance, university degrees, and transportation are authorized for all GOJ employees.

The incentive system is automated, as might be expected for a system of this complexity. Individual officers can track the results of their disclosure or seizure and, to a certain extent, relate the penalty share to their monthly paycheck.

c. Customs Progress

The Customs Department and the GOJ have paid a certain amount of attention to moderating the penalty-based incentive plan so as to somewhat decrease incentives to discover infractions which, by creativity and imagination, may be stretched to be construed as violations.

The share of the penalty going into the bonus fund was reduced by Law No. 20 from 40% to 33%, although an earlier draft law called for a reduction to 30%.

Also, the Customs Director's internal instructions placed a monthly ceiling on incentive payments to individuals, in addition to an already-existing ceiling per case. The motivation for the monthly ceiling was stated to be the 1994 USAID Sectoral Policy Reform Technical Support report. Thus, an individual who, before Law No. 20, earned 400 JD per case for 3 cases during a month, or 1,200 JD, now receives only 400 JD for the month. However, since the monthly ceilings are rarely reached, it is not certain that these ceilings will, in practice, actually reduce the incentive payments. The Investors Road Map noted that previous plans called for a ceiling of 200 JD every two months.

d. Conclusions concerning Incentives

The Investors Road Map recommended the replacement of the penalty-based incentive system by a combination of incentives and bonuses that are not tied to the amount of fines paid. The Customs Department and the GOJ have made some modest changes in that direction, but much more needs to be done. Incentives for finding violations are over-emphasized and incentives for other worthwhile purposes are under-emphasized. There is no comprehensive incentive plan.

The penalty-based incentive plan is not a true incentive plan, since 40-50% of the distributions go to persons or funds not related to the finding of violations. Rather, it is a combination incentive and salary supplement plan. Many officers and employees rely heavily on the penalty-based payments for their monthly compensation. This makes change difficult because it affects so many individual paychecks.

2. General Conclusions concerning Penalty-Based Incentives.

Penalty-based incentive systems do not achieve their goals, either in concept or in practice as found in Jordan. The present system should be re-designed or abandoned as soon as practicable. Such systems do not achieve their goals because they:

1. discourage or distort full compliance with the laws and regulations;

2. discourage or distort the purposes of employees incentives; and

3. are unfair to employees who do not participate in the finding of violations.

A full analysis of the advantages and disadvantages of penalty-based incentives is shown in Annex B.

However, the penalty-based system cannot be abandoned until a new system is put in its place which provides comparable compensation to the broad range of Customs employees, whether the new system includes base salary increases, other kinds of salary supplements, or other kinds of incentives.

## III. Recommendations

The following actions are recommended to improve the bank guarantee, penalty, and incentive systems so as to encourage more local and foreign private investment in Jordan, consistent with the goals of the

Investment Road Map. A chart of these recommendations, what they will accomplish, and how they should be implemented is shown in Annex C.

A. Bank guarantees

1. The Customs Department should authorize general guarantees for any kind of multiple transactions, except for parties which have a record of noncompliance with Customs obligations.

2. The Customs Department should consolidate the number of kinds of guarantees into fewer, broader kinds of guarantees, such as one general guarantee for all kinds of importations, one for all kinds of private transit, one for all kinds of private warehouses, and so forth. An example of a consolidated guarantee for importation is shown in Annex D.

3. The Customs Department should expand the principle of allowing liability beyond the amount of the guarantee to other kinds of general guarantees, based on the risk represented by the individual guaranteed party and the goods. Although it is implicit in Customs actions already taken in this direction, it should be officially recognized that allowing liability beyond the guarantee amount is not especially risky because the chances of the guaranteed party defaulting on every single transaction still open are almost zero, particularly if a risk analysis has been conducted by Customs

4. The Customs Department should establish formal or informal scoring systems for analyzing the risk represented by the various guarantees, considering such matters as the party's compliance record, the accuracy and completeness of the party's record-keeping system, the rate of duty of the goods, the existence of licensing or special permit requirements for the goods, and the ease or likelihood of theft or smuggling of the goods.

5. The Customs Department should use the general guarantee privilege and the amount of liability allowed as a compliance tool under its Comprehensive Compliance Plan, as recommended in Part B of these Recommendations.

6. The Central Bank should remove the ceiling on guaranteeing bank commissions for customs bank guarantees, allowing the market to determine the commercial rate and allowing the banks to (1) restructure the rates and (2) reduce reliance on collateral requirements as a means of controlling risk.

7. The guaranteeing banks should take into account, in assessing customer risk for customs guarantees and in determining commission rates and collateral requirements, the customer's record in (1) defaulting on the guarantees, and (2) leaving the bank to pay off on the guarantees.

8. The Investment Promotion Corporation should assert to the Central Bank and the guaranteeing banks the national economic interest in reducing the cost of guarantees, consistent with good business practices.

B. Penalties and Incentives

1. In lieu of the present incentive based on the finding of violations, the Ministry of Finance and the Customs Department should develop and implement a comprehensive incentive plan to open the possibility of bonuses to all Customs employees. A model Comprehensive Incentive Plan is shown in Annex E.

2. The comprehensive incentive plan should be funded from the share of penalties authorized in Article 242 of Law No. 20. Article 242 should be amended to reflect the intent that the share be used for the comprehensive incentive plan, as shown in the proposed law changes in Annex F. The distribution scheme of Regulation No. 24 of 1999 should be revised so that the combined share of bonuses for participants and non-participants, a total of 75%, will be distributed to the comprehensive incentive plan.

3. The Customs Department should develop and implement a comprehensive compliance plan to assure that a full array of compliance techniques, including penalties, is used in bringing about the maximum compliance with the law by importers and other parties involved in laws and regulations enforced and administered by the Customs Department. A model Comprehensive Compliance Plan is shown in Annex G.

4. In connection with the comprehensive compliance plan, all clearing agents should be subject to competence examinations, including (on a one-time basis, existing clearing agents), as shown in the proposed law changes in Annex F. The Director should issue or revise instructions concerning clearing agents authorized under Article 169 (A), (B), and (C) of Law 20 to deregulate the number of clearing agents, the locations at which they are authorized to do business, and the amount of their fees, and leave these matters to the marketplace. The Director should reserve the right to intervene by discipline or removal from practice, when market forces fail or agents engage in fraud against clients, deceitful practices, or anti-competitive practices. To implement these changes the Director should work with the clearing agents union to emphasize the importance of improving the performance level of clearing agents in enhancing their role in the importation process. The Investment Promotion Corporation should emphasize the importance of clearing agent changes within the business community.

5. In connection with the comprehensive compliance plan, importers and other parties should be required to maintain records and accounts of their importations, exportations, and other transactions under Law 20, so as enable the Customs Department to properly verify those transactions, as shown in Annex F.

6. Discrepancies in declarations resulting from clerical errors and matters of legal interpretation should not be considered as violations of Law No. 20. The anomaly concerning application of the law concerning discrepancies of over or under 10% of the value or weight should be corrected by deleting Article 198(a)(2) of Law No. 20. Discrepancies in declarations resulting from causes other than clerical error, matters of legal interpretation, or intent (such as simple or gross negligence) should be increased to 50 - 500 JD by inclusion in Article 199 of the Law. Intent, as set forth in Article 205 of the Law, should be defined to assist the Customs Department in identifying smuggling offences. Proposed texts for these changes are set forth in Annex F.

7. The Ministry of Finance and the Customs Department should set as a long-term goal (for accomplishment in not more than 3 years) the elimination of the diversion of fines and proceeds of confiscation into a Customs incentive fund, as now provided in Article 242 of Law No. 20, in favor of a combined wage and incentive plan that provides equivalent compensation for Customs officers and employees. To accomplish this goal, a study should be conducted to (1) review the incentive plans of other Jordanian government agencies for appropriate incentive models (including especially the Income Tax Department model), (2) gauge the impact of Customs basic salary increases on overall GOJ wage policies, (3) determine the optimum mix of basic salary increases and incentives in an overall employee compensation package, and (4) determine the mix of funding for the combined wage and incentive plan between the State budget and the customs fee authorized under Article 161 of Law No. 20.